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IN THE

Supreme Court of the United States

October Term, 1976

Supreme Court, U. S.
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No. 76-541

MAX GRENADER, ROGER W. ACH II, ANN FIELDER, JOHN GERSTAD, LEE GERSTAD, CELIA GORDON, P. BENJAMIN KAUFMAN, DOROTHY KIMBALL, GERTRUDE LANDAU, HORACE MILLS, ADRIENNE MINASSIAN, SYLVIA JANE MORRISON, CORA MULLER-THYM, H. VICTOR SCHWIMMER, FRANCES STEIN, MARION TERRES, JOHN TERRES, MASIE G. WILKINSON, OLGA RUDNYANSKY, MADELINE SCHAINUCK,

Petitioners,

v.

MILTON SPITZ, HENRY SPITZ and JEROME SPITZ, d/b/a THREE FORTY FIVE MANAGEMENT CO., 34557 TENANTS CORP.,

Respondents,

and

BERNARD COOPER, ROBERT JULIUS, JERRY V. SHIELDS, JR., WILLIAM L. LIVINGSTONE, JOEL KEY RICE, FRANK MOORMAN, JUDITH ANN TAFT, GLORIA LISTER a/k/a GLORIA HAHN, SYLVIA SPITZ, ERNEST BORKLAND, JAMES DANIEL COTTON, BOBBY MITCHEL and S. MERCER MOORMAN,

Additional Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

BRIEF OF RESPONDENTS IN OPPOSITION

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TABLE OF CONTENTS

	PAGE
Questions Presented	1
Statement of the Case	2
Argument	4
I. The principles enunciated in *United Housing Foundation, Inc.* v. *Forman,* are applicable here	5
II. The Court of Appeals properly applied the economic reality test to the facts of this case	6
A. The Court of Appeals properly found that the cooperative apartments here were sold as residential housing for personal use	7
B. The Court of Appeals properly found that the cooperative's "shares" did not otherwise have any of the characteristics of "securities"	9
C. The Court of Appeals properly found that the cooperative's "shares" were not "investment contracts"	11
Conclusion	12

TABLE OF AUTHORITIES

PAGE

Cases:

Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975), 95 S.Ct. 1917, 44 L.Ed. 2d 539 4

Securities and Exchange Commission v. C. M. Joiner Leasing Corp., 320 U.S. 344 (1943), 64 S.Ct. 120, 88 L.Ed. 88 5

Securities and Exchange Commission v. W. J. Howey Co., 328 U.S. 293 (1946), 66 S.Ct. 1100, 90 L.Ed. 1244 5

Tcherepnin v. Knight, 389 U.S. 332 (1967), 88 S.Ct. 548, 19 L.Ed. 2d 564 5

United Housing Foundation, Inc. v. Forman, 421 U.S. 837 (1975), 95 S.Ct. 2051, 44 L.Ed. 2d 621 ....1, 2, *passim*

Statutes, Rules and Regulations:

15 U.S.C. §77 *et seq.*, Securities Act of 1933 ..... *passim*

15 U.S.C. §78 *et seq.*, Securities Exchange Act of 1934 ..... 2, 4, *passim*

Code of the Real Estate Industry Stabilization Association of New York City, Inc., §61 2

New York Real Estate Syndication Act, McKinney's General Business Law, §352, *et seq.* 2

New York City Rent, Eviction and Rehabilitation Regulations, §55 2

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BRIEF OF RESPONDENTS IN OPPOSITION

Questions Presented

1. Are the principles established by this Court in *United Housing Foundation, Inc.* v. *Forman*, 421 U.S. 837 (1975), applicable in determining whether "stock" in a

privately sponsored housing cooperative is a "security" for purposes of the Securities Act of 1933 ("Securities Act") and the Securities Exchange Act of 1934 ("Exchange Act")?

2. Was the "economic reality" test as enunciated in *United Housing Foundation, Inc.* v. *Forman, supra,* correctly applied to the facts of this case?

Statement of the Case

This case involves the sale of cooperative apartments in a residential building located at 345 East 57th Street in New York City (the "Building"). The sales were made in accordance with applicable New York law,* which authorizes the conversion of a landlord-owned building into a tenant-owned cooperative housing corporation.

In 1971, the owners of the Building (the "Sponsor") converted it to cooperative ownership by selling the apartments therein to the individual tenants pursuant to a written offering plan which was duly filed with the Attorney General of the State of New York. The Offering Plan was principally devoted to a description of the real estate interests being conveyed and set forth the number of shares to which a purchaser had to subscribe in order to enter into a proprietary lease for the apartment. The Offering Plan specifically provided that the apartments would be sold solely for residential use and that the maintenance fees received from the respective owners would

* The New York State Syndication Act, McKinney's General Business Law, Section 352, *et seq.;* New York City Rent, Eviction and Rehabilitation Regulations, §55; and Code of the Real Estate Industry Stabilization Association of New York City, Inc., §61.

constitute the Cooperative's sole income.* The Offering Plan contained a description of the tenants' respective statutory rights, the Cooperative's by-laws, the proprietary lease and other pertinent materials. There were no representations of potential capital appreciation contained anywhere in the Plan.**

The Offering Plan, the proprietary lease and the subscription agreement demonstrate that the purchase of stock was completely tied to the lease of an apartment. The shares cannot be transferred to a non-tenant; a terminating tenant is required to relinquish his stock and the purchaser of the apartment must buy that stock; the shares are not transferable absent a sale of the apartment; and the shares cannot be pledged or hypothecated, other than as security for the purchase of the apartment. The proprietary lease delineated the tenant's rights and obligations and fixed the method for contributions by individual apartment owners to the cash needs of the Building. Upon breach of the proprietary lease, the Cooperative can terminate the tenant's right to occupy the apartment and may compel the return of the stock appurtenant thereto.

* The Offering Plan indicated that these receipts would be slightly augmented by rental income of approximately $180 per month from a laundry concession maintained in the basement for the tenants' convenience and by a 5% commission on gross receipts from tenants who subscribed to Manhattan Cable Television. There are no other commercial units on the premises.

** In the Offering Plan, the Sponsor also agreed to purchase the apartments of all non-purchasing tenants; prior to the closing it did so through its nominee, Eileen Dosik. The Sponsor continues to hold those apartments.

Argument

Petitioners* argue that Certiorari should be granted because the question of whether "stock" in a privately sponsored housing cooperative is a security within the ambit of the Federal securities laws** is of grave national importance and has never been decided by this Court. To the contrary, as discussed in Point I, *infra,* this Court's decision in *United Housing Foundation, Inc.* v. *Forman, supra,* 421 U.S. 837, is directly applicable here, and any decision by this Court in this case would necessarily be repetitive. Further, as discussed in Point II, *infra,* the Court of Appeals correctly applied the standards set forth in the *Forman* decision to the facts of this case.

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* Only two of the petitioners were actual purchasers of the "stock" at issue in this action. Thus, this action also presents the question of whether the remaining petitioners have standing under this Court's decision in *Blue Chip Stamps* v. *Manor Drug Stores,* 421 U.S. 723 (1975), an issue the Court of Appeals did not reach because of its decision that the "stock" here was not a security for purposes of the Federal securities laws.

** Petitioners would have this Court believe that, absent protection of the Federal securities laws, prospective purchasers of cooperative apartments will be without legal protection. This is simply untrue, as is evidenced by the proceedings brought by petitioners in the New York courts. They commenced an Article 78 Proceedings against the Attorney General of the State of New York and respondents herein in June, 1972 challenging the Attorney General's acceptance of the Plan and, in July, 1975, they commenced an action alleging common law fraud, based on the same allegations of omissions and misrepresentations alleged in this action.

I

The principles enunciated in *United Housing Foundation, Inc.* v. *Forman,* are applicable here.

Petitioners argue that the Court of Appeals erred by applying the principles set forth in *United Housing Foundation, Inc.* v. *Forman, supra,* a case involving a publicly sponsored housing cooperative, to the instant case, which involves a privately sponsored housing cooperative. They contend that the "scope of *Forman* does not extend to stock in . . . privately sponsored cooperatives." (Petition for Writ of Certiorari at p. 19*).

In *Forman,* this Court reiterated that, in determining whether a particular instrument is a "security", "form should be disregarded for substance and the emphasis should be on economic reality." 421 U.S. at 848 (citing *Tcherepnin* v. *Knight,* 389 U.S. 332, 336 (1967)). The factual situation before this Court in *Forman* involved a publicly sponsored housing cooperative. However, this decision cannot be limited to that particular factual situation, since it depended on the purpose and meaning of Congress' definition of the term "security". Indeed, this Court has held, under diverse factual situations, that the "economic realities" must be considered in determining whether there is a "security". *Tcherepnin* v. *Knight, supra; Securities and Exchange Commission* v. *W. J. Howey Co.,* 328 U.S. 293 (1946); *Securities and Exchange Commission* v. *C. M. Joiner Leasing Corp.,* 320 U.S. 344 (1943). Applying this stand-

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* The Petition will hereinafter be cited to as "Pet." with the appropriate page reference following.

ard, this Court concluded in *Forman,* in language especially apt here:

> "There is no doubt that purchasers in this housing cooperative sought to obtain a decent home at an attractive price. But that type of economic interest characterizes every form of commercial dealing. What distinguishes a security transaction—and what is absent here—is an investment where one parts with his money in the hope of receiving profits from the efforts of others, and not where he purchases a commodity for personal consumption or living quarters for personal use." 421 U.S. at 858.

Petitioners argue that the "economic reality" analysis should not be applied here merely because this action involves a privately sponsored housing cooperative as opposed to the publicly sponsored cooperative at issue in *Forman.* The obvious impact of petitioners' argument is that the economic realities must be disregarded—a position completely contrary to all applicable case law.

II

The Court of Appeals properly applied the economic reality test to the facts of this case.

The Court of Appeals did not hold, as petitioners appear to suggest, that the *Forman* decision determined that "stock" in *all* privately sponsored housing cooperatives was not a "security". To the contrary, the Court of Appeals recognized that *Forman* requires a detailed analysis of the facts to determine whether there is a "securities transaction". Applying the criteria laid down in *Forman,* the Court of Appeals held that the shares of "stock" in this case were not "securities".

A. The Court of Appeals properly found that the cooperative apartments here were sold as residential housing for personal use.

This Court in *Forman* held that "when a purchaser is motivated by a desire to use or consume the item purchased —'to occupy the land or develop it themselves' . . . —the securities laws do not apply." 421 U.S. at 852-53. This Court then looked at the manner in which those cooperative apartments had been sold and concluded that "there can be no doubt that investors were attracted solely by the prospect of acquiring a place to live." 421 U.S. at 853.

Here, too, the Court of Appeals found that what had been sold was residential housing for personal use. 537 F.2d at 617. To arrive at that conclusion the Court of Appeals considered the Offering Plan, noting:

> "The content of the plan was principally devoted to the real estate interests being conveyed. The purchaser had to enter into a subscription agreement for the number of shares allocated to the unit in which he was interested, and was thereby entitled to a proprietary lease for his apartment. The apartments would be sold for residential use and the maintenance fees received from the respective owners would constitute the cooperative's income." 537 F.2d at 615.

The Court also determined that purchasers had not been enticed to purchase by promises of profit in the Offering Plan or anywhere else. As the Court of Appeals stated:

> "There is nothing in the record before us to support the contention that the investor here was attracted by the prospect of realizing a profit on his investment. While the court below found that the tenants were at-

tracted by the dual motives of obtaining housing and realizing a profit on their investments, the documentary evidence, which is all that was before the court, would indicate that the profit motive, if any, was purely incidental. The offering plan, which includes the subscription agreement, the proprietary lease and the by-laws is barren of any representation or intimation of anticipated profits. Unlike the hawking siren song of the promoter, the plan here is a prosaic recitation of the financial facts underlying the transaction with an exhaustive recitation of the physical properties and condition of the Building and the apartments offered as well as the terms of the tenancy and the obligations of the lessee. There is no reference to the possibility or probability of profits. In fact, there is ample warning that the annual maintenance charges set forth for each apartment (together with the purchase price of the shares fixed for each unit) are only estimates." 537 F.2d at 618-19.

Based on the facts contained in the record, the Court of Appeals concluded that the "transaction here essentially involves the acquisition of a residence". 537 F.2d at 618.

Petitioners now contend that the apartments at issue in this case were offered as investments (Pet. at pp. 13, 24-25).* This assertion does violence to the facts and was specifically found by the Court of Appeals to have no basis in the record. 537 F.2d at 618-19.

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* The petitioners argue that "most of the shares" purchased during the offering period were resold shortly after the initial offering (Pet. at p. 13). This fact is simply untrue and without any basis in the record.

B. The Court of Appeals properly found that the cooperative's "shares" did not otherwise have any of the characteristics of "securities".

The shares of stock involved here were found by the Court of Appeals to have no characteristics materially different from those found not to constitute a security in *Forman*. Petitioners argue that the shares of stock in this case differ from those in *Forman* in that they were "transferable" and "negotiable" (Pet. at pp. 24-25). In fact, the *Forman* shares and those at issue here are virtually identical. Here, as in *Forman*, the shares were non-negotiable "absent a sale of the apartment" and were completely tied to the apartment. 537 F.2d at 617.

Petitioners also argue that the "stock" here is a security because, unlike the shares in *Forman*, dividends may be declared on the shares (Pet. at pp. 9, 24-25). This contention was found by the Court of Appeals to be without factual support. As the Court of Appeals stated:

> "There is no affirmative provision for the payment of dividends in the transaction before us . . . The appellees argue that . . . . [Article III, §10 of the Cooperative's by-laws] implies that distribution[s] may be made out of earnings and profits. Under the economic reality test of *Forman*, it is indeed impossible to envisage what cash dividends would be reasonably anticipated from the operation of a cooperative residential housing venture. The only substantial income of the Corporation arises from the payment of rent or maintenance charges by the tenants, estimated on the basis of the cash requirements needed to operate the Building on an annual basis plus the creation of reserves for contingencies. Unlike *Forman*, there are no commercial tenants in the Building. Aside from rental income are

the fees realized from the coin-operated laundry and cable television which, of course, are tenant-financed and not significant. There is not a scintilla of evidence that any tenant was induced to become a purchaser of shares because he might expect to realize dividends. Whatever profit might be realized could only result in a reduction of the maintenance charged. Realistically, in view of continuously escalating labor, fuel and maintenance costs, all that a tenant could reasonably expect would be escalating monthly charges. The argument that a share purchaser was induced to acquire his apartment because of an opportunity to realize cash dividends is altogether frivolous." 537 F.2d at 617.

Petitioners further argue that the shares of stock in this case are materially different from those found in the *Forman* case not to be a "security" since tenants here receive one vote per share as opposed to the one vote per apartment in *Forman* (Pet. at pp. 9, 12-13). In fact, the tenant in this case votes based upon the size and location of his apartment; hence, as the Court of Appeals found, "the relationship of share purchase here to actual apartment residency is even more direct than in Co-op City, where the apartments were fungible as far as voting rights were concerned." 537 F.2d at 618.

Finally, petitioners argue that the stock here is different from the stock found in *Forman* not to be a "security" since it may be sold at a profit. The Court of Appeals, in applying the "economic reality" test, considered all of the facts, including the possibility that, due to the vagaries of the real estate market, the apartments might appreciate in value, and concluded that the apartments had been purchased as living quarters and not as an investment. 537 F.2d at 617-18.

In short, despite superficial differences between *Forman* and this case, the "economic realities" are the same and therefore the stock involved here, as the Court below properly held, is not a "security" within the purview of the Federal securities laws.

C. The Court of Appeals properly found that the cooperative's "shares" were not "investment contracts".

This Court in *Forman* also considered whether or not the cooperative apartments sold in that case were "investment contracts" as that term is defined in the Federal securities laws, although it found no distinction between a "security" and an "investment contract". In deciding that they were not, this Court looked for "the presence of an investment in a common venture premised on a *reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others.*" 421 U.S. at 852 (emphasis added). This Court concluded that such expectations were not present since the purchasers in *Forman* had been attracted by the prospect of acquiring a residence and not by the "hope of receiving profits from the efforts of others." 421 U.S. at 858.

Petitioners here, like their counterparts in *Forman*, argue that these apartments are "investment contracts" (Pet. at pp. 22-26). The Court of Appeals rejected their argument, applying the same test utilized in *Forman*, and found that there was no evidence that the purchasers had been attracted by the prospect of realizing a profit. 527 F.2d at 618. To the contrary, the Court below found on the facts properly before it that the purchasers had ac-

quired their apartments for personal occupancy. 537 F.2d at 618.

Finally, the Court of Appeals also rejected petitioners' contention that any potential increase in value of a cooperative apartment resulted from the "efforts of . . . a third party". It observed that, while efficient management of a cooperative may enhance its desirability as a place to live, "it is hardly a factor which would result in the appreciation in value of the [Cooperative's] shares . . ." 537 F.2d at 619. Such appreciation, the Court concluded, "will depend upon the general housing market, the status of the neighborhood and the availability of credit." *Id.* at 619.

Conclusion

For the foregoing reasons, the Petition for a Writ of Certiorari should be denied.

Respectfully submitted,

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